

Message Text

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ACTION ARA-14

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INFO AMEMBASSY GUATEMALA

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AMEMBASSY SAN SALVADOR

AMEMBASSY TEGUCIGALPA

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GUATEMALA ALSO FOR ROCAP

E.O. 11652: NA

TAGS: BEXP, EAID, EFIN, PINT, NU

SUBJECT: LIQUIDITY IN NICARAGUAN BANKING SYSTEM EVAPORATES;

SOME ECONOMIC PROBLEMS LIA AHEAD

SUMMARY: EXCESS LIQUIDITY IN NICARAGUAN BANKING SYSTEM, WHICH HAD PREVAILED THROUGHOUT MUCH OF 1977, HAS EVAPORATED IN RECENT WEEKS OWING PRIMARILY TO A SHARP DROP IN DEPOSITS AND CONTINUED HIGH CREDIT DEMAND. LOCAL BANKING ASSOCIATION IS NEGOTIATING WITH CENTRAL BANK FOR INCREASED REDISCOUNTING SINCE THE BANKING SYSTEM HAS VIRTUALLY NO LIQUIDITY MARGIN AT PRESENT. UNLESS GON UNDERTAKES REMEDIAL FINANCIAL MEASURES, LACK OF LIQUIDITY COULD HAVE SERIOUS ECONOMIC REPERCUSSIONS OVER THE NEXT FOUR MONTHS OR SO. RECENT URBAN GUERRILLA ACTIVITY MAY MAKE COMMERCIAL BORROWING FROM ABROAD MORE DIFFICULT; SOME U.S. BANKS HAD IMPOSED /COUNTRY LIMITS" ON LONAS TO NICARAGUA EVEN BEFORE RESURGENCE OF GUERRILLA PROBLEM. FOREIGN COMMERCIAL BANKS ARE NOT YET LIKELY TO FEEL CONSTRAINED TO HELP

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BAIL NICARAGUA OUT OF ITS ECONOMIC PROBLEMS. NOTWITHSTANDING THESE GROUNDS FOR CONCERN ABOUT NICARAGUA'S CONCOMIC/FINANCIAL SITUATION, THERE IS NO EVIDENCE OF ANY MARKED INCREASE IN FLIGHT CAPITAL, AND NO CAUSE FOR IMMEDIATE ALARM. END SUMMARY.

1. RELIABLE SOURCES IN LOCAL BANKING CIRCLES HAVE INFORMED EMBASSY THAT THE EXCESS LIQUIDITY IN THE NICARAGUAN BANKING SYSTEM,

WHICH HAD ARISEN LARGELY OWING TO WINDFALL PROFITS FROM COTTON AND COFFEE EXPORTS, HAS EVAPORATED IN THE PAST FIVE OR SIX WEEKS. SOURCES SAY THAT A RECENT SHARP DROP IN DEPOSITS, COMBINED WITH HIGH CREDIT DEMAND THROUGHOUT THE YEAR, HAS REDUCED COMMERCIAL BANKS' LIQUIDITY MARGIN TO VIRTUALLY NIL AT PRESENT. LOCAL BANKING ASSOCIATION HAS BEGUN NEGOTIATING WITH CENTRAL BANK FOR INCREASED REDISCOUNTING.

2. DEPOSITS TRADITIONALLY ARE AT THEIR HIGH POINT IN APRIL, THE END OF THE HARVEST SEASON FOR MAJOR EXPORT CROPS, AND START TO DECLINE IN MAY, REACHING A NADIR IN AUGUST AS GROWERS NORMALLY USE OWN FUNDS TO FINANCE AGRICULTURAL INPUTS FOR NEXT CROP. DEPOSITS USUALLY REMAIN LOW UNTIL HARVEST SEASON BEGINS IN NOVEMBER. THIS YEAR, HOWEVER, COFFEE AND COTTON FARMERS TENDED TO LEAVE THEIR PROFITS FROM THE 1976/77 CROPS IN THE BANKS, THUS CAUSING DEPOSITS TO REMAIN AT UNUSUALLY HIGH LEVEL THROUGH AUGUST. (THAT LEVEL, AT \$265 MILLION, WAS OVER 17 PERCENT HIGHER THAN IT WAS A YEAR AGO.)

3. DEPOSITORS NORMALLY WITHDRAW FROM THEIR ACCOUNTS IN SEPTEMBER TO PAY THEIR ANNUAL TAXES AND BANKERS HAD EXPECTED THIS. WHAT THEY HAD NOT EXPECTED, HOWEVER, WAS THAT MANY SHORT-TERM BORROWERS WOULD SEEK EXTENSIONS OF THEIR DEBTS COMING DUE DURING SEPTEMBER-OCTOBER. THIS IS WHAT CAUGHT THE BANKING SYSTEM UNAWARE. HENCE, THEY SYSTEM EXPERIENCED RELATIVELY SUDDEN, HEAVY WITHDRAWALS AND A ROLL-OVER OF SHORT-TERM OBLIGATIONS WHICH QUICKLY USED UP NEARLY ALL OF THE SYSTEM'S LIQUIDITY.

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4. THE LIQUIDITY SHORTFALL, UNLESS COMPENSATED BY CENTRAL BANK REDISCOUNTING OR OTHER FISCAL MEASURES, COULD HAVE SERIOUS REPERCUSSIONS FOR THE ECONOMY OVER THE NEXT FOUR MONTHS. OUR SOURCES INDICATE THAT EXPORT EARNINGS FROM THE 1977/78 CROPS WILL BE GENERATED MORE SLOWLY THAN IN THE PAST, SINCE PRODUCTS WILL PROBABLY NOT BE SOLD AS SOON AS HARVESTED. (SOFTENING IN COTTON AND COFFEE PRICES UNDOUBTEDLY CONTRIBUTE TO THIS ASSESSMENT.) SOURCES BELIEVE THAT ECONOMIC DOLDRUMS COULD EXTEND INTO MARCH 1978 AS THE ECONOMIC SYSTEM IS NOT AS FLEXIBLE AS IT WAS LAST YEAR.

5. SOURCES ALSO INDICATED THAT RECENT GUERRILLA ACTIVITY IN URBAN AREAS WILL PROBABLY HAVE A NEGATIVE EFFECT ON GON'S ABILITY TO BORROW ABROAD. (GON HAS CONTRACTED OVER \$200 MILLION IN NEW LOANS DURING PAST THIRTEEN MONTHS.) SOURCES ADDED THAT SOME U.S. COMMERCIAL BANKS HAD, AS EARLY AS LAST SUMMER, DECIDED TO APPLY "COUNTRY LIMITS" ON NEW LOANS TO NICARAGUA, I.E., SUCH BANKS HAVE DECIDED NOT TO EXPAND EXISTING LINES OF CREDIT TO NICARAGUA UNLESS A GIVEN LOAN PROPOSAL LOOKS VERY PROMISING ON ITS OWN MERITS. SAME SOURCES ANTICIPATE THAT OTHER BANKS MAY NOW DECIDED TO APPLY THOSE LIMITS TO NICARAGUA.

6. COMMENT: IT IS EASIER FOR FOREIGN COMMERCIAL BANKS TO TIGHTEN LINES OF CREDIT NOW SINCE THERE IS LITTLE DOUBT THAT NICARAGUA WILL BE ABLE TO REPAY PAST DEBTS, ALBIET WITH ACCOMPANYING STRINGENT ECONOMIC POLICIES. THEREFORE, SUCH BANKS PROBABLY FORSEE NO PRESENT NEED TO CONSIDER REFINANCING NICARAGUA'S EXPECTED HIGH LEVELS OF DEBT SERVICING OVER THE NEXT FOUR YEARS IN ORDER TO BAIL OUT THE GON.

7. SOURCES ARE UNAWARE OF ANY RECENT, MARKED SPURT OF FLIGHT CAPITAL BUT EXPECT THAT THE RHYTHM OF THE FLOW OF MONEY OUT OF THE COUNTRY MAY HAVE INCREASED SOMEWHAT IN PAST WEEKS. THE CENTRAL BANK, THEY SAY, HAS ALWAYS ASSUMED THAT SOME MONEY IS CONTINUALLY LEAVING THE COUNTRY BUT HAS NOT BEEN BOTHERED BY THIS PEHENOMENON.

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8. COMMENT: ALTHOUGH THE ABOVE DEVELOPMENTS IN NICARAGUA'S ECONOMIC-FINANCIAL SITUATION BEAR CLOSE WATCHING OVER THE NEXT FEW MONTHS, WE DO NOT YET SEE GROUNDS FOR ALARM.
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